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No. 77-1611

In the Supreme Court of the United States

OCTOBER TERM, 1977

HERCOFORM INCORPORATED, PETITIONER

v.

CHICAGO TITLE INSURANCE COMPANY, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT

MEMORANDUM FOR THE FEDERAL RESPONDENT

WADE H. MCCREE, JR.,
Solicitor General,
Department of Justice,
Washington, D.C. 20530.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 15-23) is reported at 568 F. 2d 217. The oral opinion of the district court (App., *infra,* pp. 1a-4a) is not reported.

JURISDICTION

The judgment of the court of appeals was entered on January 5, 1978. On March 21, 1978, Mr. Justice Brennan extended the time within which to file a petition for a writ of certiorari to and including May 15, 1978. The petition was filed on May 11, 1978. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether a private mechanic's lien that has not become choate before a federal lien attaches takes precedence over the federal lien.

STATEMENT

1. In September 1971 petitioner contracted with Sherred Corp. to fabricate, deliver, and erect prefabricated housing units for the Sherred Village project in Bath, Maine (C.A. App. 15-17).[1]

In May 1972 the project's owner and developer, Sherred Village Associates, obtained a $3.98 million mortgage loan, from New England Merchants National Bank, on the Bath property (C.A. App. 22-29). This loan was insured by the Department of Housing and Urban Development (HUD) pursuant to Section 236 of the National Housing Act, as added, 82 Stat. 498, and amended, 12 U.S.C. 1715z-1.[2] The mortgage and a regulatory agreement between HUD and Sherred Village Associates were recorded on May 2, 1972, with the appropriate county office (C.A. App. 16, 29, 35). Chicago Title Insurance Co. provided title insurance for the benefit of the Bank; among the risks insured against were liens existing as of the date of the mortgage (C.A. App. 16).

Petitioner completed work in late 1973, filed a $440,986.03 mechanic's lien against the property on December 20, 1973, and on the same date filed suit in the Sagadahoc County Superior Court to enforce its lien (C.A. App. 18).

On December 19, 1974, while that case was pending and after Sherred Village Associates had defaulted on its mortgage payments, the Bank assigned its interest in the mortgage to HUD; this assignment was appropriately recorded. The bank warranted to HUD that the mortgage

[1]"C.A. App." refers to the Appendix in the court of appeals.

[2]Section 236 authorizes HUD to insure mortgages on rental developments of five or more units for "lower" income families or elderly or handicapped persons.

assigned was prior to all mechanics' and materialmen's liens filed after the recording of the mortgage in May 1972 (C.A. App. 40).[3]

2. In April 1976 Chicago Title and the Bank brought a declaratory judgment action in the United States District Court for the District of Maine, seeking a determination that petitioner's mechanic's lien is inchoate and junior to the mortgage insured under Section 236 (C.A. App. 4-8). Petitioner argued in response that Maine law should be applied, and that under Maine law its lien was perfected and obtained priority as of the date the construction contract was signed, September 29, 1971.

The district court concluded that federal law should be applied, and that, under the federal rule, the lien "first in time" should be "first in right" (App., *infra*, p. 2a). It then determined that petitioner's mechanic's lien could not be first in time because it was not "choate" either at the time the mortgage was first recorded or at the time it was assigned to HUD; the lien was not choate because it was still subject to judicial contest in proceedings pending in state court (App., *infra*, pp. 2a-3a). The court concluded that the HUD-insured mortgage therefore was entitled to priority (App., *infra*, p. 4a; Pet. App. 13-14).

3. The court of appeals affirmed (Pet. App. 15-23). It observed that since the enactment in 1966 of amendments limiting the choateness doctrine as applied to federal tax liens, see 26 U.S.C. 6323, "the Circuits have split on the issue of whether the doctrine of choateness should continue to be applied in priority disputes involving non-tax federal liens" (Pet. App. 20) and that "[t]echnically, there

[3]We are informed by HUD that HUD has not foreclosed on the mortgage, and that Sherred Village Associates remains the owner and operator of the mortgaged property.

being no legislation or Supreme Court opinions governing the non-tax federal lien-mechanics' lien dispute * * *, we are free to fashion our own rule" (*id.* at 21). But the court concluded that it would "resist the temptation to announce our own rule" because of "skepticism that, in this arena of complex relationships intimately affected by both federal and local law, we would make any valuable contribution by adding a further complication" (*id.* at 22). It determined that any "substitute formula" that it could devise would be unsatisfactory, particularly because the lien at issue was a mechanic's lien to which the Uniform Commercial Code does not apply. Applying local law as a substitute would "incorporate many local eccentricities," while applying the Federal Tax Lien Act of 1966 would "require contractors to be aware of the possible applicability of two sets of rules," for those amendments do not uniformly follow state law[4] (Pet. App. 22-23).

DISCUSSION

This case raises the issue whether a private lien that has not become "choate" before a federal lien attaches can take precedence over the federal lien. This question is before the Court in *Kimbell Foods, Inc.* v. *Republic National Bank*, 557 F. 2d 491 (C.A. 5), certiorari granted *sub nom. United States* v. *Kimbell Foods, Inc.*, No. 77-1359, May 15, 1978. We accordingly suggest that the Court defer consideration of the petition in this case pending the disposition of *Kimbell*. If the Court agrees with our argument in *Kimbell* that a private lien achieves priority against a federal non-tax lien only from the date

[4]26 U.S.C. 6323(a) and (h)(2) provide that a mechanic's lien achieves priority for purposes of comparison with tax liens "on the earliest date such lien becomes valid under local law against subsequent purchasers without actual notice, but not before [the mechanic's lienor] begins to furnish the services, labor or materials."

it becomes "choate," it would follow that the decision of the court of appeals here is correct. In any other event, the proper disposition of the present case would depend on the Court's rationale in *Kimbell*.

This case also is related to *United States* v. *Crittenden*, 563 F. 2d 678 (C.A. 5), petition for certiorari pending, No. 77-1644, which involves a loan, made directly by a federal agency, that is in competition with a repairman's lien. The repairman's lien was neither "choate" nor perfected under any other theory at the time the federal lien attached. *Crittenden* therefore presents the question whether a private lien can be accorded a "super-priority" over a federal lien. Our petition in *Crittenden* observed that the Court might disagree with our contentions concerning the choateness doctrine and still decline to accord "super-priority" to liens that come into existence, under any test, only after the federal lien attaches.[5]

The present case does not involve a question of super-priority; petitioner apparently asks this Court to apply Maine law, which would give petitioner an early date for perfection of its lien but would not grant any form of priority over liens that were perfected before that time. But because this case, like *Crittenden*, involves a claim by a mechanic or repairman who has worked on an item of personal or real property, the Court may wish to defer consideration of this petition until it has decided *Crittenden*.[6]

[5]We have furnished copies of the petitions in *Kimbell* and *Crittenden* to counsel for the private parties in this case.

[6]Our petition in *Crittenden* asks the Court to set that case for consideration in tandem with *Kimbell*, so that it may consider claims of both ordinary and super-priority. Because the mechanic's lien here is entitled under state law to early but not super-priorty, this case apparently does not present any issue that would not be before the Court in *Kimbell* or *Crittenden*.

CONCLUSION

The Court should defer consideration of the present petition until it has disposed of *Kimbell* and *Crittenden*.

Respectfully submitted.

WADE H. MCCREE, JR.,
Solicitor General.

JUNE 1978.

DOJ-1978-06

APPENDIX

UNITED STATES DISTRICT COURT
DISTRICT OF MAINE
SOUTHERN DIVISION

CHICAGO TITLE INSURANCE COMPANY, ET AL.,

PLAINTIFFS

v.

SHERRED VILLAGE ASSOCIATES, ET AL.,

DEFENDANTS

CIVIL NO. 76-56-SD

BENCH RULING OF THE COURT AT THE CONCLUSION OF ORAL ARGUMENTS IN THE ABOVE-ENTITLED ACTION

Pursuant to notice, hearing was had in the above-entitled matter before Honorable Edward T. Gignoux, Judge, United States District Court, District of Maine, at the United States Courthouse, Portland, Maine, on Wednesday, February 16, 1977. At the conclusion of oral argument of counsel, the Court ruled from the bench as follows:

THE COURT: Counsel, thank you all very much. As previously noted, the Court has reviewed the record and the briefs submitted by counsel and has read the *Bellegarde Custom Kitchens* case and the significant cases cited in the briefs. It is prepared to rule at this time.

Plaintiffs seek a declaratory judgment as to the priority between the real estate mortgage executed and recorded, together with a HUD regulatory agreement, on May 2d 1972, and subsequently assigned to the Secretary of HUD on December 19, 1974, recorded December 30, 1974, and a mechanic's lien asserted by the defendant Hercoform,

Incorporated, arising as a result of materials and labor furnished in the construction of housing upon the real estate in question. The facts have been stipulated and the Court finds the facts as stipulated.

The legal issues have been well briefed and orally argued by able counsel. The Court is persuaded that the present case is in all respects save one controlled by the prior decision of this Court in *Bellegarde Custom Kitchens v. Select-A-Home, Incorporated* and *LaPointe Bros., Inc. v. Chabot*, 385 F. Supp. 318 (D. Me. 1974). As this Court concluded in that case, federal law governs the priority of liens when a debt owing the federal government or an agency of the federal government is involved. The federal rule for determining the relative priority between a federal lien and a state-created lien, in the absence of a controlling federal statute, is "first in time, first in right." In applying this federal rule, the Supreme Court of the United States has consistently held that in order for a non-federal lien to be entitled to priority over a federal lien, the non-federal lien must be choate at the time the federal lien arises. The authorities have further established that a non-federal lien is choate only if the identity of the lienor, the property subject to the lien and the amount of the lien are established, and that a non-federal lien is not choate until the claim is final and not subject to a judicial contest as to its validity or amount. Furthermore, the authorities are clear that the determination of whether a non-federal lien is choate is to be made in accordance with federal law, even though the application of state law might bring about a different result.

On the record here presented, there can be no question but that if, as in *Bellegarde*, the mortgage in question were a direct federal mortgage, the federal lien would be entitled to priority over the Hercoform lien. Hercoform's

lien was not choate under applicable federal law either at the time the mortgage and regulatory agreement were executed and recorded or at the time the mortgage was assigned to HUD. As a matter of fact, the Hercoform lien is not yet choate under the federal definition, inasmuch as the amount of the lien has not yet been established. Indeed, the claim itself is still subject to judicial contest in proceedings pending in the courts of the State of Maine.

The only question presented by this case which was not previously ruled upon by this Court in *Bellegarde Custom Kitchens* is whether the fact that the mortgage here in question was not a direct federal mortgage but a federally-insured mortgage is a controlling distinction. The authorities are clear, however, that the result must be the same where, as in the present case, the mortgage, although taken by a private lender, was insured by a federal agency and subject to the terms of a regulatory agreement which disclosed to the world the possibility that in the event of default an assignment to the federal agency would ensue and a federal lien be asserted. *See, e.g., United States v. Eklund*, 369 F. Supp. 1052 (S.D. Ill. 1974); *Kimbell Foods, Inc. v. Republic National Bank of Dallas*, 401 F. Supp. 316 (N.D. Texas 1975); *J.S. Purcell Lumber Corp. v. Hanson*, 405 F. Supp. 1130 (E.D. Va. 1975); *United States v. Chester Heights Association*, 406 F. Supp. 600 (D.S.C. 1975).

The defendant Hercoform in the instant case places great reliance upon *H. B. Agsten & Sons, Inc. v. Huntington Trust & Savings Bank*, 388 F. 2d 156 (4th Cir. 1967). A careful analysis of the factual situation presented in that case, as well as the law applied, persuades this Court, however, that it is plainly distinguishable. In *Agsten*, the court was confronted with a circular lien situation. The court broke the circle in the manner which seemed to it most fair to the various parties

concerned. In the present instance, no circular lien problem is presented. The issue as agreed by the parties is as to the priority as between the federal government mortgage lien and the state-created mechanics lien.

The defendant Hercoform also argues that the enactment by Congress of the Federal Tax Lien Act of 1966, which subordinated federal tax liens to various state security interests, including state mechanics liens, evinces a federal policy to subordinate all federal liens to liens created by state law. As defendant's counsel correctly points out, two circuit courts have accepted this line of reasoning. It has, however, been rejected by other circuit courts and by this Court in *Bellegarde Custom Kitchens.* The Court is not persuaded that the views there expressed should be modified at this time.

The Court holds that the lien of the mortgage dated May 2d, 1972, given to New England Merchants National Bank and assigned to the Secretary of Housing and Urban Development on December 19, 1974, is entitled to priority over the mechanics lien asserted by the defendant Hercoform, Incorporated. The declaratory judgment requested in the complaint will be entered.